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Banking Sector Development in Ghana for the Period 1989 to 2010

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Abstract:
The aim of this paper is to examine the development of the banking sector in Ghana over the past 22 years. To achieve this, an attempt is made to trace the growth and increase in the number of commercial banks in Ghana over the period. This paper has classified banks into two categories-local and foreign. It attempts to find out the extent to which they find the Ghanaian market attractive thereby enhancing competition in the industry. The two groups are compared with each other to determine their efficiency which is measured in terms of share of customer deposit, share of total assets of the industry, share of Gross loans, share of Government securities, share of loan loss provision, share of profit and return on assets. Finally, the paper examines the extent of financial deepening of the banking sector by analysing the following financial deepening indicators: ratio of bank asset to GDP, ratio of money supply to GDP, ratio of currency in circulation to money supply, credit to the private sector as a percentage of gross loans, government securities as a percentage of gross loans, and profit as a percentage of GDP. The result is that financial deepening in Ghana has improved but not to the extent of removing the imperfections.
Keywords: Development, Growth, commercial bank, financial deepening, local banks. foreign banks

1.0 Introduction

A strong and vibrant banking sector promotes a country's economic development and growth. A good banking industry provides the enabling environment for growth in both the public and private sectors. There is a positive relationship between financial sector development and economic development. The depth of the financial sector of any country is generally found to promote economic growth. A well performing banking sector just like any financial system increases economic efficiency, supports investment and encourages growth. The presence of banks in an economy is expected to make the buying and selling of funds done at a relatively cheaper cost than when fund owners and borrowers deal directly with each other. Profitability of the industry attracts more participants into the industry depending on the ease of entry which is also dependent on the capital requirement and the legal system.

This paper investigates the deepening of the financial sector in Ghana. There is quite a number of research work on the growth and development of the banking industry in Ghana. This paper is unique in the sense that it limits its scope to the commercial banking sector in Ghana, that is the deposit money banks and comparing the performance of the locally-owned banks to the foreign banks.

2.0 Banking Reform in Ghana

The banking industry in Ghana has evolved significantly over the years through the effects of structural reforms. By the mid 1980's, some Ghanaian banks had become weak, financially distressed and insolvent with significantly non-performing loan books. To address this problem and with the assistance of the World Bank, the Government in the late 1980s launched the Financial Sector Adjustment Program (FINSAP) to restructure distressed banks, clean up non-performing assets, restore banks to profitability, reform legislation and the banking supervisory system, allow the entry of new banks and other financial institutions and develop the money and capital markets. These efforts led to the liberalization of the Ghana's financial sector, making the industry more competitive and attractive to investors. The industry is currently one of the most buoyant and competitive yet profitable sectors of the economy. Despite all these it is clear that all is not well with the sector as there are signs of inefficiencies as portrayed by high interest rate spreads and loan losses.

3.0 Literature Review

3.1Importance of the Banking Sector

Sinkey (1992), Saunders (1997), Levy (2008), Said and Tumin (2011) and Eroglu and Citozi (2010), all agree that banks play a unique (special) role in the economy and therefore, require extraordinary (special) regulatory treatment. What a financial system should be able to provide according to Frankel (2001) is the ability to function efficiently, to support adequate levels of investment smoothly, and to withstand adverse economic shocks.

3.2 Financial Intermediation

A financial intermediary is an institution that channels funds from surplus-spending units to deficit-spending units. Loosely, surplus-spending units are savers and deficit-spending units are investors. Commercial banks, belong to a general class of financial intermediaries. Sinkey (1992), indicates two fundamental goals that financial intermediaries must meet if they are to survive. First, they must package their liabilities in forms that are attractive to surplus-spending units. And secondly, they must package their assets in forms that are attractive to deficit-spending units. For commercial banks, this means that their loan and deposit services must be appropriately priced and conveniently available to customers relative to those of their competitors.

3.3 Financial Deepening

Financial deepening measures the degree to which financial institutions in a country are able to meet the financial needs of society by intermediating funds. The usual indicators include the ratio of money supply to GDP (M2/GDP or M2+/GDP), the currency-money supply ratio, and credit to the private sector as a share of GDP. In this article other indicators of financial sector development have been analysed such as the growth in terms of number of banks and branches (foreign and local), deposit growth, total bank asset growth in relation to GDP, percentage of loan to GDP, the ratio of deposit to GDP, total profit to GDP, loan loss provision as a percentage of Gross loans, the percentage of credit to the private sector to gross loans and the ratio of Government securities to total loans are used to measure the growth and development of the banking sector.

3.4 Benefits of Foreign Entry

Stoica and Capraru (2007), indicate that the main benefits of foreign entry are higher competition in the banking sector, leading to higher quality, more variety of services at cheaper prices; this will benefit consumers of banking services. Demirguc-Kunt and Huizinga (1998), found in their research study that foreign banks in Bangladesh have higher margins and profits compared to domestic banks in developing countries, while the opposite holds in developed countries. Garcia-Herrero (2006), observes that foreign banks generally count with a better production technology, which allows them to be more efficient and, thereby, more profitable. Koeva (2003) agrees with the findings of Demirguc-Kunt and Huizinga (1998) in his research with the Indian banking system. Granade (2007) also confirms the position of earlier researchers that foreign owned banks have been operating with larger spreads compared to their indigenous counterparts.

4.0 Data

This paper uses the annual reports of all banks that operated in Ghana between the years 1989 and 2010 and also annual reports of Bank of Ghana to obtain the macro economy data . The data therefore include data for banks that are still in operation and those that operated within the period but have either been closed or acquired. The banks have been put into two distinct groups, the first one being all banks classified as local banks and the second is made up of those classified as foreign banks. The data for the various banks are aggregated to represent the data for the group. Appendices 1 and 2 contain a summary of analysis of the industry data collected.

5.0 Data Analysis and Discussion

5.1 Performance of Local Versus Foreign Banks in Ghana

5.1.1 Growth in Number of Participants

By 1989 there was a total of eleven banks in Ghana, made up of eight local banks and three foreign banks. By 2010 the total number of banks had grown to twenty-six, consisting of thirteen banks apiece. The number of banks in the industry therefore grew by over 136 per cent over the 22 year period (1989 to 2010) with the growth higher among the foreign banks of over 333 percent and 62.5 per cent for the local banks. By the end of the year 2010, there were twenty-six banks operating in Ghana, thirteen foreign and thirteen local. Compared to 1989, we can conclude that the competition in the industry has become keener especially with the entry of more foreign banks than local banks resulting in the same number of banks for both categories by 2010. Available data indicate that branches of banks grow annually. For example, in 2004 there were 360 branches of all banks in Ghana. By 2010 this number had grown to 776, that is 115.5 percent growth within a period of seven years.

5.1. 2 Share of Customer Deposit

Foreign banks as at 1989 had under their control about 18.3 per cent of total deposit of all commercial banks in Ghana. However, by 2010, the percentage holding of foreign banks had changed to 51.3 per cent. This confirms the gradual entry and dominance of foreign banks of the banking industry in Ghana. If in the year 2010 there were the same number of local banks as the foreign banks then if customer deposit in the hands of foreign banks are more than the local banks, then we can conclude that foreign banks have become more attractive to depositors than local banks.

5.1.3 Share of Total Assets

In 1989, local banks owned 82.7 percent of the assets of the industry with the rest going to the foreign banks. By 2010 this had changed with the local banks possessing only 48.7 percent of total assets of the industry. This shows that the foreign banks did not only grow in numbers but also in value exhibiting more strength in the industry than the local banks.

5.1. 4 Share of Gross Loans

Local banks in 1989 contributed about 81.7 percent to total loans of all commercial banks in Ghana. By 2010, even though the level of contribution of local banks to total loans of commercial banks dropped, it still had about 59 percent. This gives an indication that local banks tend to support local businesses through loans than the foreign banks. This is quite encouraging as the main reason for establishing local banks is to support the development of the business sector since the foreign banks are perceived to be shying away from the private business sector.

5.1. 5 Share of Government Securities

That the foreign banks are not willing to support the business sector as much as the local banks is confirmed by the fact that foreign banks contributed 64 percent of the total amount invested in government securities in 2010. Government securities are risk-free assets to the banks and it can be concluded that as long as they are able to pay for their cost of funds, foreign banks are more comfortable investing in the cheaper but less risky assets in the industry.

5.1. 6 Share of Loan Loss Provision (LLP)

The figure represents what the bank thinks is sufficient to cover losses on its outstanding loans. In this way loan loss reserve calculations can reflect positively or negatively upon a bank's solvency. The ratio of loan loss provision (LLP) to Gross Loans represents the credit risk of the industry. Analysing this ratio over the past years reveal that generally loans advanced by foreign banks performed better than those given by the local banks. In 1989, as much as 69 percent provision was made by the local banks on Gross Loans as compared to 13.8 percent by the foreign banks. The loan loss provision/Gross Loan ratio improved somehow for both sectors but with the foreign sector showing better results. Whereas between 2004 and 2010 the highest ratio recorded by the local banks was 16.4 percent in 2007 and the lowest 7.08 percent, the foreign banks recorded the highest loan loss provision/Gross Loan ratio of 9.2 percent in 2010 and the lowest of 3.1 percent in 2007. Even though loan loss provisions are still high, it seems there is some sanity compared to what prevailed in the 1980s.

5.1. 7 Share of Profit

In the late 1980s most of the local banks were declaring net losses as against profits by the foreign banks. Despite the fact that there were pockets of losses in the subsequent years among the local banks, foreign banks were always delivering profits. The only times that foreign banks made losses were in their first year of establishment. In 1994, with a total of nine out of thirteen, the local banks' contribution to the commercial banks' profit for the year was 76.9 percent. This however, changed in 2004, with eleven local banks contributing only 38.9 percent and seven foreign banks taking the rest. In 2007, there were twelve local banks and ten foreign banks, however, the foreign banks' share of that year's profit was 60 percent and the twelve local banks taking only 40 percent. The dominance of the foreign banks in profitability became much more pronounced in 2010 when the two sectors had thirteen banks each. Local Banks accounted for only 30.3 percent and foreign banks had the rest.

5.1.8 Return on Assets

A better ratio for measuring a profitability of a company and for that matter a bank is the return on assets (ROA), which describes the rate of return management is able to earn on the assets that it has available to use during the year. In 1989, ROA for all local banks was negative 2.6 percent because of the losses declared by the majority of the banks. This is in contrast to a positive of 2.9 percent by foreign banks. The best periods for the local banks were 1994 to 2000 when the lowest ROA was 6.6 percent in 1997. The best period for the foreign banks seem to coincide with that of the local banks. However, for the foreign banks it starts from 1991 with a ratio of 8.4 percent and ends in 2003 with 7.1 percent. Its highest was however, recorded in 1997 at 9.2 percent. The years 2009 and 2010, have so far proved to the worst for the two sectors of the industry. Whereas the local banks recorded 1.2 percent and 2.1 percent, the foreign banks achieved 2.7 percent and 4.5 percent for 2009 and 2010 respectively. However, generally foreign banks performed better than the local banks.

6.0 Financial Deepening

6.1 Ratio of Total Bank Assets to GDP

This section examines the relationship between total assets of commercial banks and GDP. This indicates the growth of the banking sector in terms of its total assets in relation to GDP. Between 1989 and 1992 the ratio fell between 0.14 and 0.17. This increased to 0.22 in 1993 and 0.24 in 1994. Between 1995 and 1998 it lied between 0.17 and 0.19. This shows some improvement from 0.21 in 1999 to 0.32 in 2000, dropped to 0.25 in 2002 and dropped further to 0.23 in 2005. From 2007 it had been a steady increase annually from 0.26 to 0.39 in 2010. The last four years showed marked improvement in the banking sector growth by recording ratios of between 0.33 in 2007, improving in 2008 to 0.36, and 0.38 in 2009 and finally to 0.39 in 2010.

6.2 Ratio of Money supply To GDP

This ratio indicates the growth of money supply in the economy. A higher ratio is an indication of the development of the financial sector and for that matter financial deepening. Whereas the highest ratio recorded between 1989 and 1993 was 0.14 in 1993, there was a slight improvement from 1994 of 0.16 to 0.19 in 2000. From 2001, the ratio jumped to 0.23 and has maintained 0.20 in 2004 and 2005 being the lowest but showed steady increase from 2006 at 0.23 to 0.26 in 2007, 0.27 in 2008, 0.28 in 2009 and ending at 0.31 in 2010. The ratios in the last five years show significant improvement in the deepening of the financial sector in Ghana.

6.3 Ratio of Currency in Circulation To Money Supply

Data on this section is available from 1997 to 2010. The currency component of the total money supplied is sometimes known as "money stock currency" and it is defined as currency in circulation outside the Treasury, the Central Bank, and outside the vault of depository institutions. A higher ratio is also an indication of the development of the financial sector.

The ratio was rather relatively high at 0.30 in 1997 and then dropped to 0.29 in 1998 and went as low as 0.22 in 2000. The best ratios were recorded between 2001 at 0.28 and 2004 also at 0.28. The highest of 0.31 was recorded in 2003.

6.4 Credit Support to the Business/Private Sector

Two ratios are used to measure the extent of the support the banks provide to the private sector which form the majority of the business sector. The first one is the ratio of loans to the private sector to Gross Loans. The second, is the amount invested in Government securities by banks as a ratio of Gross loans. It is assumed that the more the government competes with the business sector for commercial bank funds the more they make borrowing expensive for the business sector and also the more scarce the loanable funds become.

With the available data from 1992 to 2010, the lowest percentage of loans to the private sector was 73 percent in 2000 and 2007 and the highest being 87 percent in 1998. However, using total investment as a ratio of Gross loans, it is clear that the business sector is crowded out by the government borrowing. This is very significant especially between 1990 and 1995 when investment in government securities forms 133.5 percent to 177.1 percent of Gross loans. This is a sign that the banks put more of their monies into government securities than into loans. The situation however, began to change in favour of loans from 1996 with 98.6 percent, 1997 with 84.5 percent and getting as low as 54.9 percent in 2000. Even though 2002 figure went up to 81.7 percent, the period between 2004 and 2010 saw drastic reduction in the percentage with 2008 recording the best of 23.9 percent.

7.0 Prudential Regulation and Supervision

Other factors that have enhanced banking intermediation in Ghana are the establishment of new prudential regulation and tighter supervision, an improvement of accounting and disclosure standards, the adoption of better techniques for risk evaluation and asset and liability management and, last but not least, the involvement of foreign investors. Significant and rapid changes in the financial system over the past years necessitated the promulgation of new laws and regulations. One may ask why the need for stringent regulation and supervision of the industry.

The preamble for the legal and regulatory framework of the Bank of Ghana stipulates that the central bank shall have overall supervisory and regulatory authority in all matters relating to banking and non-banking financial business with the purpose to achieve a sound, efficient banking system in the interest of depositors and other customers of these institutions and the economy as a whole. The functions and responsibilities of the Central Bank as a Regulator are defined in Act 612 and Act 673 as follows:

Consequently, the Central Bank exercises its mandate to ensure that, depositors' funds are safe, the solvency, good quality assets, adequate liquidity and profitability of banks are maintained, adherence to statutory and regulatory requirements is enforced, fair competition among banks, and the maintenance of an efficient payment system.

In summary, the laws governing banking operations have provisions regarding licensing, withdrawal of license, and arrangement for examining and monitoring banks, powers, and duties as well as protection of the supervisor.

Finally, to enhance the legal and regulatory framework, the Bank of Ghana supervisory functions are designed to be consistent with the Basle Core Principles for Effective Banking Supervision. The primary objective of the central bank of Ghana is to maintain stability in the general level of prices. The Bank shall also support the general economic policy of the Government and promote economic growth and effective and efficient operation of banking and credit systems in the country, independent of instructions from the Government or any other authority.

Since 2003, Universal Banking has replaced the three-pillar banking model – development, merchant and commercial banking. It has leveled the playing field, and opened up the system to competition, product innovation and entry. The licensing policy of the Bank of Ghana continues to pursue the underlying objectives of establishing a unique and rich banking tradition.

8.0 Conclusion

Over the past 22 years, between 1989 and 2010, Ghana's banking sector has experienced tremendous growth and development in terms of the number of banks and their branches especially the foreign ones. The number of banks in the industry has grown by 136 percent over the period under review. The research has revealed that the foreign banks are more efficient than the local ones using the ratio ROA and loan loss provisioning. Customer deposit and assets of foreign banks also grew faster than those of the local banks. However, the foreign banks are much more risk averse and therefore prefer investing more in government securities than the risky loans.

The second part of the research which attempts to review the extent of financial deepening of the banking sector, confirms that there is improvement in terms of ratio of bank assets to GDP and ratio of money supply to GDP. However, in terms of the ratio of currency in circulation to money supply, the 1990s were the best years. In terms of support to the business or private sector, the best results were achieved between 2004 and 2010.

We can conclude that over the 22 year period, there has been a remarkable development of the banking sector in Ghana. This however, does not mean there are no bottlenecks in the system. The fact that interest rate spreads are high especially in relation to the situation in the developed countries means that a lot more has to be done to remove the imperfections.

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Appendix 1

TABLE OF INDICATORS AND RATIOS

Year/Variable	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
No of Local Banks	8	8	9	9	9	9	9	9	11	11	11	10	10	11	11	11	11	11	11	12	13	13
No. of Foreign Banks	3	3	4	4	5	4	4	3	5	5	5	5	5	5	6	7	7	8	10	10	13	13
Total no. of Banks	11	11	13	13	14	13	13	12	16	16	16	15	15	16	17	18	18	19	21	22	26	26
Ownership of Banks-Local (%)	72.7	72.7	69.2	69.2	64.3	69.2	69.2	75	68.7	68.7	68.7	66.7	66.7	68.7	64.7	61.1	61.1	57.9	52.4	54.5	50	50
Ownership of Banks-Foreign (%)	27.3	27.3	30.8	30.8	35.7	30.8	30.8	25	31.3	31.3	31.3	33.3	33.3	31.3	35.3	38.9	38.9	42.1	47.6	45.5	50	50
No. of Bank Branches	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	360	392	450	595	640	706	776
LLP/G. Loan-Local Banks (%)	69	51.9	38.4	26.8	23.4	20	21.7	15.4	27.3	23.1	12.1	11.4	17.8	17.6	17.5	13.5	12.9	11.8	16.4	6.8	10.1	7.1
LLP/G. Loan-Foreign Banks (%)	13.8	11.8	18.8	14.5	12.4	9.1	4.8	3.6	2.5	2.4	2.6	6.0	11.3	9.3	8.4	10.7	6.0	3.9	3.1	4.7	8.4	9.2
ROA-Local Banks	-2.6	6.8	2.9	2.4	7.7	7.4	9.5	5.8	6.6	4.7	6.8	8.9	7.8	5.1	3.6	4.3	3.1	3.4	2.6	2.3	1.2	2.1
ROA-Foreign Banks	2.9	5.6	8.4	4.2	7.0	7.0	8.5	9.0	9.2	7.6	6.9	6.9	8.6	7.2	7.1	7.0	6.0	5.2	3.8	2.7	2.7	4.5
Bank Asset/GDP Ratio	0.16	0.17	0.14	0.16	0.22	0.24	0.19	0.19	0.17	0.19	0.21	0.32	0.28	0.25	0.27	0.24	0.23	0.27	0.33	0.36	0.38	0.39
M2+/GDP	0.12	0.10	0.09	0.12	0.14	0.16	0.17	0.16	0.16	0.14	0.15	0.19	0.23	0.22	0.21	0.20	0.2	0.23	0.26	0.27	0.28	0.31
Cu/M2+	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.30	0.29	0.26	0.22	0.28	0.28	0.31	0.28	0.26	0.23	0.24	0.23	0.23	0.24
PSC/Gross Loans (%)	N/A	N/A	N/A	78	79	79	82	81	83	86.8	85.5	73	74	85.7	76.8	80.9	81.4	83.5	73	78.7	82	85.5
Govt. Sec/Gross Loans (%)	70.1	144.2	177.1	141	155.3	133.5	135.2	98.6	84.5	79.4	78.4	54.9	61.2	81.7	72	67.9	54.2	46.9	32.4	23.9	41.2	57.5
PBT/GDP (%)	2.7	1.1	0.6	0.5	1.6	1.7	1.8	1.3	1.3	1.1	1.4	2.5	2.3	1.5	1.4	1.3	1.1	1.2	1.1	0.9	0.8	1.3

Source: Compiled from Annual Reports of Commercial Banks in Ghana and the Central Bank

Appendix 2

Appendix 2: Performance-Percentage Share of Local vs Foreign Banks

Year/Variable	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Share of PBT (Local) %	-130	83.6	56.8	64.5	80.2	76.9	72.5	59.6	53.9	43.5	53.1	57.1	55.6	51	35.5	38.9	33.9	39.8	40	46.2	28.2	30.4
Share of PBT (Foreign) %	29.2	16.4	43.2	35.5	19.8	23.1	27.5	40.4	46.1	56.5	46.9	42.9	44.4	49	64.5	61.1	66.1	60.2	60	53.8	71.8	69.6
Share of Total Deposit (Local) %	81.7	76.1	75.7	72.2	67	65.6	65.5	64.6	57.7	54	48.6	51.2	49.3	53.2	46.3	48.7	49.8	48.9	49.1	45	47.4	48.7
Share of Total Deposits (For) %	18.3	23.9	24.3	27.8	33	34.4	34.5	35.4	42.3	46	51.4	48.8	50.7	46.8	53.7	51.3	50.2	51.1	50.9	55	52.6	51.3
Share of Total Assets (Local) %	82.7	80.6	79	81.9	78.6	75.8	70.3	69.5	61.8	55.7	53.4	50.9	58	59.4	51.9	50.8	50.3	50.5	49.1	50.4	47.5	48.7
Share of Total Assets(For.) %	17.3	19.4	21	18.1	21.4	24.2	29.7	30.5	38.2	44.3	46.6	49.1	42	40.6	48.1	49.2	49.7	49.5	50.9	49.6	52.5	51.3
Share of LLP (Local) %	95.7	94.8	88.1	86.2	86.1	87.9	92.1	91.3	95.8	94.2	69.8	71.6	62.3	73	71	58.1	70.4	79.3	86.1	60.7	62.7	57.2
Share of LLP (Foreign) %	4.3	5.2	11.9	13.8	13.9	12.1	7.9	8.7	4.2	5.8	30.2	28.4	37.7	27	29	41.9	29.6	20.7	13.9	39.3	37.3	42.8
Share of Govt Security (Local)%	87.7	84.9	84.1	78.5	74.1	72.2	70.3	69.9	69.2	70.2	55.8	57.4	63.8	71	56.3	52.5	48.1	42.8	42.9	43.8	31	36
Share of Govt Security (For.) %	12.3	15.1	15.9	21.5	25.9	27.8	29.7	30.1	30.8	29.8	44.2	42.6	36.2	29	43.7	47.5	51.9	57.2	57.1	56.2	69	64
Share of Gross Loans (Local) %	81.7	80.6	78.3	77.2	76.6	76.8	72.1	71.1	68	63	58.5	57	51.1	58.8	51.5	52.4	52.8	55.8	54	55.8	58.4	59
Share of Gross Loans (For.) %	18.3	19.4	21.7	22.8	23.4	23.2	27.9	28.9	32	37	41.5	43	48.9	41.2	48.5	47.6	47.2	44.2	46	44.2	41.6	41
Share of PBT (Local) %	-130	83.6	56.8	64.5	80.2	76.9	72.5	59.6	53.9	43.5	53.1	57.1	55.6	51	35.5	38.9	33.9	39.8	40	46.2	28.2	30.4
Share of PBT (Foreign) %	29.2	16.4	43.2	35.5	19.8	23.1	27.5	40.4	46.1	56.5	46.9	42.9	44.4	49	64.5	61.1	66.1	60.2	60	53.8	71.8	69.6

Source:Compiled from Annual Reports of Commercial Banks in Ghana and the Central Bank